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WEITERE INFORMATIONEN OK

Thursday, August 16, 2007

Exit and freedom

Why did the early United States have much stronger property rights and far lower taxes than today, even though it is nominally governed by the same political form and a constitution that has undergone only a few amendments? Why do Hong Kong and Singapore currently lead the world in economic freedom? Why did the fall of the Berlin Wall spell the end of European communist states? What political changes or changes to our own lives would give us stronger property rights and lower taxes?

What stands out about Singapore and Hong Kong --and other entities that have the most economic freedom in their region, such as Bahrain in the Arab Middle East -- is that they specialize in international trade. To encourage business travel, they must put few restrictions and tax penalties on travel. Large proportions of their population have strong international social ties. Large proportions of the population of these countries could easily move out of the country if their local rights were violated. Strong international personal and business ties allow them to quickly reestablish themselves in a different, but not so foreign, country.

In other words, when a small country specializes in mediation of international trade, the exit costs for the people from whom it collects most of its tax revenue is low. To maintain their tax revenues they must maintain a productive international trade business, and to maintain international trade these governments must thus maintain low exit costs for a large proportion of their population.

Laffer curve of tax rate versus tax revenue (black) and corresponding curve of GDP (green). When governments maximize tax revenue the prosperity and economic freedom of their taxpayers suffer. Credit: Mark Byron.

Governments of almost any form try to maximize their tax revenues, and government employees also often gain personal satisfaction from being able to control the lives and property of others (this goes under various euphemisms, such as the ambitions to "change the world" and "make a difference.") This process is facilitated primarily by high exit costs and is limited almost only by limits on governmental ability to increase exit costs. The maximum point on theLaffer curve -- the most tax that a government can collect -- is lower and occurs at a lower percentage tax rate in countries where exit costs are low. Thus

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Nick Szabo

"A premier thinker about history, law and economics, and the lessons they have for security." -- Adam Shostack, Emergent Chaos

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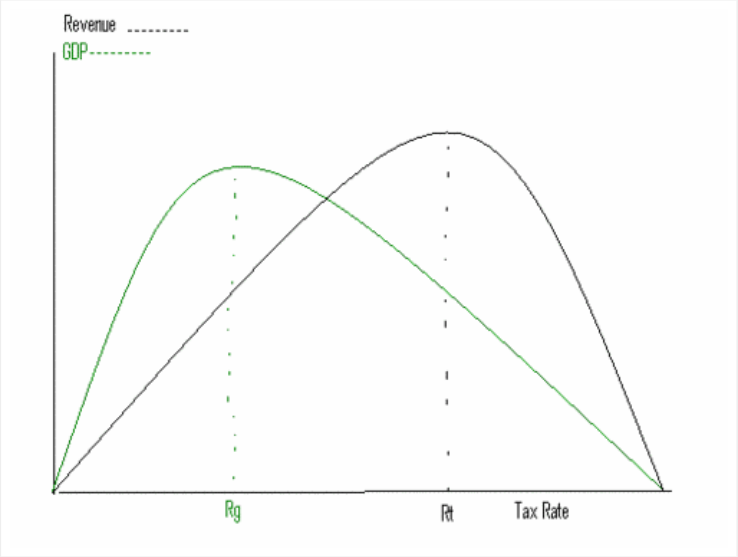

the tax rates inHong Kong, Singapore, and Bahrain are lower than among their culturally similar neighbors that do not specialize in as internationalimermediaries.

At the other end of the spectrum from Hong Kong and Singapore are countries with isolated populations, with poor access to world communications and travel. Add to this countries where tax revenues can be gained from taxing agricultural land or minerals rather than potentially mobile "human capital." These countries tend to have the fewest freedoms. Even among highly developed countries, those with more homogeneous populations that speak a tongue seldom spoken outside the country -- and thus far stronger internal than international social ties -- tend to tax their "human capital" the most, e.g. the Scandinavian countries.

In other words:

(1) the governments of Singapore and Hong Kong have to encourage free travel to and from many other countries, to encourage the constant human interchange that is essential to international trade, making it impractical to set up onerous travel restrictions,

(2) most residents of Singapore and Hong Kong have strong social ties -- both business and personal -- outside the country, and

(3) the vast majority of residents of almost all other countries are tied to their territories by strong internal social networks and the lack of external social networks that could support them if they needed to escape. That makes it easy for governments to tax, regulate, and control the residents, for the same reason that it's easy for prison guards to abuse inmates -- it's hard to escape.

The American colonies and the early American republic both had remarkably strong property rights and very low taxes by our standards, despite sharp changes in the form of government. With few changes in the form of government since, taxes have risen almost tenfold and property rights often now mean little more than the right to keep after-tax capital gains.

The answer to this American puzzle is again exit costs. Farmland was the dominant form of wealth in the 18th and early 19th century, and practically free yet very good farmland was available in America on the western frontier. Any oppression, any high taxes or other violations of property rights could be countered by pulling up stakes and moving west. If you didn't want your local farmers to leave you had to respect their rights, in sharp contrast to the traditional form of agriculture where serfs were stuck on the land. On the other hand, black slaves in the U.S. provide a sharp contrast to the remarkably free white farmers -- a condition explained by state and federal fugitive slave laws, which spread a virtual Iron Curtain for slaves across the entire vast expanse of the United States, in free states as well as slave states.

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Human capital is very easy to tax when it gathers in large organizations, such as modern corporations, as these organizations must be audited, and auditing provides the information needed for the income tax, by far the most lucrative form of tax ever developed. When America's frontier disappeared, when the good agricultural land was claimed and industrial wealth became more important than agricultural wealth, and industrial wealth was flowed in easily audited forms through corporations and to their employees, taxes rose and property rights for all started to erode, a process that continues to this day.

Countries that depend on human capital, as almost every country these days does, often throw up legal barriers to exit. Countries that worry about "brain drain" sometimes charge extortionate passport fees. These are examples of countries erecting virtual Berlin walls in order to raise the exit costs of their countries, suppress jurisdictional competition, and thus increase their tax revenues. Another form of this are long-arm statutes, especially when used to collect taxes on companies that have only "minimal contacts" with a jurisdiction.

Why are governments imposed on us rather than chosen? Why can't we shop for countries like we shop for cars? Why has progress in jurisdiction shopping movements such as the Free State Project been so slow? Because interstate travel is considered a fundamental right under U.S. law, the exit costs imposed by law on moving from state to state are very low. The slow progress of the Free State Project points up several factors:

(1) that many, if not most, taxes and other violations of property rights considered onerous come from federal rather than local governments, and moving just from state to state within the United States does not avoid these,

(2) that no state, not even New Hampshire, is so remarkably better than any other state to motivate many people to move, and

(3) that local social ties -- whether for personal or business relationships -- are much more expensive for most people to break than the gains to be had from increased economic freedom between one state and another.

In the United States and today in most of the world, exit costs are imposed primarily by the ways we live our lives -- and in particular by our personal and business networks -- not by artificial Berlin wall like barriers. Modern deprivations of liberty have much more to do with this fact than with the oftenexaggerated differences in forms of government or with supposedly crucial rights such as the right to vote. Today, never in the United States have so many people had the right to vote, yet never in the United States have we had so high taxes and so few property rights.

With the fall of communism, for most people in the world government restrictions on exit are no longer the dominant barrier to exit. Our lack of liberty has rather to do with the fact that the vast majority of our strong social ties lie within a territory monopolized by a nation-state. Any form of large modern nation-state that we can practically expect to encounter, as well as any state of any size that restricts emigration, will engage in extortionate deprivations of property that many people in many earlier times and places, such as colonial America, did not tolerate.

How, then, can one best protect one's rights? By living one's life in a way that makes exit costs low:

> Be prepared to vote with your feet. Add interstate and international diversity to your social networks -- both personal and business. Lower your costs of exiting, if the need should arise, the jurisdictions that impose on the territories wherein you reside. Repeatedly in history -- from the old American frontier to the fall of the Berlin Wall to modern jurisdictions that specialize in international trade -- low exit costs have not only enabled liberty for the individual and the small group, but they have more than any other factor motivated the larger jurisdiction to provide the most important rights and freedoms for those who stay put. Grow interpolitical roots so that no single polity can chop down your tree. The good news is that modern communications, travel, and standardization of international languages (mostly on English) have made diversifying our social networks -- growing international roots - far easier than ever before in history.

Our new omniscient savior

Ten ways to make a political difference

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Despite the closing of physical frontiers, which has had an extremely deleterious impact on freedom, other trends may be bringing about the lowering of exit costs. International communications networks and the international standardization on a few languages (and perhaps even just one, which quite fortunately for my readers is the one I'm currently writing in), combined with low international travel costs, are leading to the development of more strong personal and business social ties that cross borders. Multinational small businesses are joining multinational corporations in developing cross-border business ties.

But there are also many threats by governments to re-establish or increase exit costs by throwing up virtual Berlin walls and fugitive taxpayer networks. Extraterritorial assertions of jurisdiction, especially of tax jurisdiction, threaten to throw up enforcement networks akin to the old fugitive slave laws in the antebellum United States. Freedom of travel is being threatened by paranoid responses to the overblown threat of terrorism -- but at least one good group is fighting to counter this threat. To counteract these threats, basic freedoms must be protected by our courts from encroachment by other governmental branches. The U.S. Supreme Court counts both voting and interstate travel as fundamental rights. Of these fundamental rights, travel -- but especially *international* travel -- the right to pass through the airports and Brandenburg Gates and Checkpoint Charlies of the world -- is by far the more important.

Posted by Nick Szabo at 8:32 PM

14 comments:

ru said...

Another wonderful post! Nick Szabo is the best political blogger I know of.

2:49 PM

Daniel A. Nagy said...

Amen.

3:25 PM

Daniel A. Nagy said...

Growing international social and business ties is certainly very useful, liberating and empowering. So is learning the English language for those, who do not happen to speak it natively. Knowing other languages (esp. those which I would call transcultural languages -- e.g. Mandarin, Russian, Spanish, Arabic, Turkish, French, Swahili, Dutch and to some extent German) can be useful, too. I am a strong believer in solving one's problems within one's own sphere of competence rather than hoping to do so through political campaigning.

However, there's also much to be said about entry costs (since they obviously influence exit costs). The current diplomatic arrangement with passports (given by the government of the country of citizenship) and visas (given by the government of destination country) is a major source of travel costs and risks (and frustration).

The usual analogy of proponents of inbound border controls that while it is not okay to lock people up in our apartment, it is perfectly okay not to let anyone in is fundamentally flawed. When a consulate arbitrarily denies visa to someone with an invitation or, worse yet, a border-guard denies entry to someone with a visa, they act like a condo janitor preventing your guests from entering the condo.

In most civilized countries there are formal rules and procedures about obtaining a passport and once the requirements are fulfilled, getting one becomes a right. On the other hand, granting visas or even admission at border crossings and airports is still subject to arbitrary decisions (and hence humiliation, extortion and frustration) in which basic legal principles are routinely flouted.

There is a fundamental (IMHO) freedom which I miss very much from international relationships: **the right to invite**. I see no valid justification for denying the right to assume responsibility for a foreigner and have said foreigner as a guest.

How can the right to invite be gained and defended? Is politics the only option? Are there already sound legal arguments in its favor?

1:00 AM

nick said...

DN: "The usual analogy of proponents of inbound border controls that while it is not okay to lock people up in our apartment, it is perfectly okay not to let anyone in is fundamentally flawed. When a consulate arbitrarily denies visa to someone with an invitation or, worse yet, a border-guard denies entry to someone with a visa, they act like a condo janitor preventing your guests from entering the condo."

Although I strongly agree with the observation that a country that keeps its people in (a la the old Iron Curtain) is far worse than a country that keeps people out, you make a very good point here that is worth extensive consideration.

If I live in a bad neighborhood it is quite nice to have good locks and a doorman who keeps out the riffraff. (In fact I speak from personal experience here). I have to trust the doorman and apartment management with much of my security. But, as you say, the doorman should respect and trust my preferences when I invite in guests.

Besides locking in vs. locking out, I'd add another important distinction -- who controls the locks. Ideally, I or my fellow family members control the locks on our house and we can (and often do) lock other people out. At the opposite end of the freedom spectrum is a prison where somebody else controls the locks and locks me in. So the basic distinction between locking in and out is indeed a sound and crucial one and is closely related to the issue of who controls the locks and how they, in turn, are controlled.

There are, however, a couple problems scaling these examples up. At a somewhat larger scale, I have to trust a condo association or a gated community. Often that is OK because our interests are aligned and they operate in a market where exit costs are low enough that they don't want to get a reputation for locking their residents in. But when we scale up to the state, or the federal, things get far more problematic. A lock or guard or fence or airport security check that usefully keeps out the terrorists and other riffraff today can become a Berlin Wall to keep people in tommorrow, with minimal technological change. Such devices require severe and religiously followed legal protections, which are being ignored in the mad rush to keep out terrorists and various other undesirables.

DN: "There is a fundamental (IMHO) freedom which I miss very much from international relationships: **the right to invite.** I see no valid justification for denying the right to assume responsibility for a foreigner and have said foreigner as a guest."

This is a very good idea, but what about the responsibility part? Are you willing to post a substantial bond?

If I invite somebody into the apartment complex and they trash the place, that could very well violate my lease terms, or simply result in my lease not being renewed. Also, it is a local enough situation that it is easy for them to figure out which renter is responsible for the vile guest. But if stranger X from unknown neighborhood Y invites unknown foreigner Z into the country, how are the border guards supposed to know to trust either the invitor or the invitee?

There is also the problem that if the person is a competent adult you have no right to control him, so that it would be hard to impute to you legal responsibility for his acts under the common law (although I may just be unaware of precedent off the top of my head -- any reader feel free to chime in with any analogical legal precedents you know of). It seems to require some sort of special statute, contract, or both, which makes it an interesting experiment to try but not something that we can just force on the entire border system overnight or be certain that it will eventually work.

3:46 PM

nick said...

BTW, I seriously appreciate the positive feedback, thanks.

3:51 PM

Daniel A. Nagy said...

Let's do a quick rundown on the rationale behind restrictions on inbound international travel.

The obvious first question is why at all are foreigners considered more dangerous than citizens? Why does the government consider locks on my front door and police patrols in the neighborhood sufficient against domestic criminals, but insufficient against foreign ones? The only acceptable answer to this, in my opinion, is that because foreigners have a safe haven against "our" law enforcement (namely, their country of citizenship) and therefore what deters citizens may not deter a foreigner. Thus, inbound restrictions are justified against citizens of countries with which the cooperation on law enforcement is less than perfect. So far, so good.

nick: *This is a very good idea, but what about the responsibility part? Are you willing to post a substantial bond?*

What if I am? Or I could buy something along the lines of a liability insurance, which would pay for the damage in the rare case of my guests wreaking havoc. In the current arrangement, however, even if I am perfectly able and willing to assume full responsibility for the actions of my guest (the ability to control the person in question is, of course, not implied, but neither is it necessary) I still cannot be sure that some bureaucrat won't ruin my plans of spending some quality time together.

nick: *If I invite somebody into the apartment complex and they trash the place, that could very well violate my lease terms, or simply result in my lease not being renewed. Also, it is a local enough situation that it is easy for them to figure out which renter is responsible for the vile guest. But if stranger X from unknown neighborhood Y invites unknown foreigner Z into the country, how are the border guards supposed to know to trust either the invitor or the invitee?*

Well, there's a problem to be solved, right?

Here we have a decision (actually two: one by the consulate and one by the border guard), which is very similar to criminal rulings, except that currently it is arbitrary, secret, and there is no right of appeal. Why?

I can even accept (for reasons too long to write down) that the burden of proof is on the inviter in the case of awarding a visa, but why is the inviter denied the chance to defend his case (for letting said foreigner in)?

Why having a visa does not reverse the burden of proof is completely beyond me. Sure, there are cases when crooks are issued a visa and the border guard is the last line of defense, but it is (or should be) very rare.

In either case, the inviting citizen should at least be informed why his invitation was overruled. And have a right to appeal, too.

How is that not implementable overnight?

5:12 PM

Daniel A. Nagy said...

What recourse do I have, if my business partner (whom I have formally invited) is denied entry and it damages my business? Can I sue the person making this decision?

5:15 PM

nick said...

DN: "What recourse do I have, if my business partner (whom I have formally invited) is denied entry and it damages my business? Can I sue the person making this decision?"

I cannot yet give legal advice, sorry (and once I can you'll have to pay, you won't get it here. :-)

If your question is about what the law *should* be, I'd say that a person unjustifiably restrained from crossing a border should be able to sue for false imprisonment, just as if they were unjustifiably restrained from walking from A to B inside a jurisdiction. But what might constitute a justification for such restraint is left as an exercise for the student. :-)

2:38 PM

nick said...

DN: "why at all are foreigners considered more dangerous than citizens?"

Foreigners are considered to be more likely to be dangerous for a large number of reasons, some of which I sympathize with:

* There are far more of them than there are citizens, and from a wider variety of cultural and political backgrounds, so one has to put up with a much greater variety of both legal and illegal behavior from them.

* They often come here in whole or in part for the greater taxpayer-funded goodies.

* They are more likely than citizens to be terrorists (a massively overhyped problem since 9/11 to be sure, but even accounting for that still an important factor to be considered).

* They might be enemy state spies or sabateurs.

* They might be part of an unassimalable population that doesn't much speak the standard language in the jurisdiction and thus presents a threat of future political violence (a la the Balkans). I'm not going to go through all the reasons this could be so here, the case has been well-argued elsewhere. But from a legal point of view I'd say that a large population that cannot read laws in the language they were written in, a population that drafts its contracts and wills in a language different from those under which legal interpretation standards have been developed, a population that cannot serve on a jury or testify in court in a language the lawyers, judge, and jury can understand, yet that population demands equal legal and political rights, presents an unacceptable legal and political burden and risk.

There are some potential solutions to these besides border checks and restraints.

* We could stop providing taxpayer-funded goodies generally. A far superior solution to border restrictions, but alas seems rather politically distant.

* We might depend on internal police to ferret out spies, sabateurs and terrorists. But putting all the burden on internal police might well demand sacrifices in internal procedural freedoms for all of us, in place of sacrifices of procedural freedoms at the border. I'm not sure that's a good tradeoff.

* We could let in everybody regardless of their English skills but let our courts then say "tough luck" to people who want to testify in a language the judge, jury, and lawyers do not understand (currently interpreters are used, but that's quite awkward and prone to errors and manipulations), or to contracts and wills not drafted in the standard legal language under which interpretational precedents have been set. Courts could stop pretending that we should or can provide people who don't speak the legal language with the same legal rights as those who do. (Any more than the Internet will let computers that don't talk IP communicate on an equal basis with those that do).

Because of the high costs in internal as well as external freedom that come from travel restrictions (per my original blog post), I'm not sure any or even all of these reasons put together are worth the problems and risks of allowing governments to restrict movements across borders. Many of them involve basic tradeoffs between border freedom and internal freedom. All of them are important considerations that can't be dismissed, nor is their any prospect of them being minimized in the political debate over borders.

3:16 PM

nick said...

DN: [Why arbitrary, secret, no right of appeal, not right for inviter to defend case, etc.]

I'm not well versed in the details of travel and immigration law (indeed with your travel experience you probabably know far more than me in this area), so I'm afraid I'm not the person to ask for justifications of specific aspects of the law or procedure. But I strongly suspect they are justified by the general policy reasons outlined in my last comment, combined with the desire to make the procedures highly efficient. Allowing hearings, trials, appeals, etc. would make the whole process very costly and, if those costs were monetarily imposed on travellers, likely deter rather than encourage international travel.

There's a chance that international traveller and terrorist databases might allow more informed decisions at less cost, but these create their own risks of abuse as well.

3:32 PM

ru said...

Since low exit costs are so essential to liberty, a good way to be nice to future generations is to oppose any movement towards world government, e.g., to oppose any augmentation of the UN's ability to tax or coerce people.

11:43 AM

nick said...

Followup: My secret tax economist friend informs me that "Tiebout competition" is the technical term most commonly used for competition between local jurisdictions. Googling that turned up some interesting things, including:

* A good Tiebout page with links to quite a few works on the subject.

* Bryan Caplan argues that property taxes raise exit costs by lowering property values, and thus stifle competition between local jurisdictions.

2:02 PM

Daniel A. Nagy said...

The question whether or not I can sue the bastard who denied visa for my business partner was rhetorical.
I already pay a lawyer on a monthly basis(*), but this question I can answer even without his advice: currently, I can't claim damages for ruined arrangements.

(*) Referring back to nick's previous post; a good lawyer is well worth the money and one can learn a good deal of real law from such a relationship.

2:04 PM

nick said...

ru: "Since low exit costs are so essential to liberty, a good way to be nice to future generations is to oppose any movement towards world government, e.g., to oppose any augmentation of the UN's ability to tax or coerce people.'

This is a very good observation. But there is a strong pressure to standardize law internationally to lower transaction costs and deal with international pollution. This will continue to give rise to entities like the WTO and international FDA- and EPA-like organizations. The trick is to do this without empowering international tax collection or more long-arm taxation.

2:25 PM

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